

Message Text

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TO AMEMBASSY OTTAWA PRIORITY

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E.O. 11652: N/A

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SUBJECT: LOS DEEP SEABED MINING

REF: OTTAWA 01935

1. RESOURCE POLICY FOR DEEP SEABED MINING IS ONE OF THE
KNOTTIEST ISSUES BEFORE THE LOS CONFERENCE. THE MAJOR
MINERAL CONSUMERS, INCLUDING THE US AND MOST OTHER
INDUSTRIAL COUNTRIES, SEEK AN INTERNATIONAL REGIME THAT
PROMOTES RATIONAL ALLOCATION OF INVESTMENT RESOURCES IN
SEABED MINING. HOWEVER, A NUMBER OF LAND-BASED
PRODUCERS ARE PRIMARILY INTERESTED IN PROTECTING THEIR OWN
CURRENT AND FUTURE MINING INVESTMENTS; THUS THEY SEEK
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RESTRICTIONS ON SEABED MINING. CANADA HAS BEEN AMONG THE
MOST FORCEFUL ADVOCATES IN THE LATTER GROUP. THEIR
PROTECTIONIST AND VEHEMENTLY STATED POSITION ON
PRODUCTION CONTROLS IS THE MAJOR POINT OF DIVERGENCE
BETWEEN THE US AND CANADA IN THE LOS CONFERENCE, AND IT
ALSO POSES AN IRRITANT IN OUR BILATERAL RELATIONS.

2. AMBASSADOR RICHARDSON PLANS TO ADDRESS THE RESOURCE
POLICY ISSUE AT LENGTH WITH CANADIAN OFFICIALS WHEN HE
VISITS OTTAWA APRIL 20-21. IN THE MEANTIME, WE SUGGEST

THAT THE EMBASSY AVOID PUBLIC DEBATE, SUCH AS RESPONDING

DIRECTLY TO THE RECENT TORONTO NEWSPAPER ARTICLE (REFTEL). ON THE OTHER HAND, THE EMBASSY MAY WISH TO DISCUSS THESE ISSUES INFORMALLY WITH SELECTED MEDIA, INDUSTRY AND GOVERNMENT REPRESENTATIVES, TO CORRECT MISAPPREHENSIONS ABOUT US INTENTIONS. BELOW ARE SUGGESTED TALKING POINTS FOR THE EMBASSY TO USE AT ITS DISCRETION, BUT NOT BEFORE THE US-GOC BILATERAL CONSULTATION ON LOS.

3. THE US WOULD PREFER A SEABED REGIME WITHOUT THE EXPLICIT PRODUCTION LIMITS CONTAINED IN ARTICLE 9 OF THE CURRENT NEGOTIATING TEXT. WE FAVOR ALLOWING MINERS TO MAKE INVESTMENT DECISIONS BASED ON PROJECTED SUPPLY AND DEMAND, AS WELL AS ON RELATIVE COSTS OF LAND VS. DEEPSEA OPERATIONS, SUCH A SYSTEM IS LIKELY TO PRODUCE GREATER ECONOMIC WELFARE FOR THE INTERNATIONAL COMMUNITY THAN ONE WHICH IMPOSES ARTIFICIAL PRODUCTION RESTRAINTS.

4. WE UNDERSTAND THE CONCERNS OF LAND-BASED MINERAL PRODUCERS INCLUDING CANADA. SINCE THE ECONOMICS OF SEABED MINING ARE STILL UNCERTAIN, ITS LONG-TERM IMPACT ON LAND PRODUCTION IS DIFFICULT TO PROJECT. NEVERTHELESS, WE BELIEVE THAT FOR THE FORESEEABLE FUTURE, GROWTH IN THE WORLD NICKEL MARKET WILL PROVIDE AMPLE ROOM BOTH FOR LIMITED OFFICIAL USE
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DEVELOPMENT OF SEABED MINING AND FOR EXPANSION OF CURRENT LAND-BASED CAPACITY. IF THE HISTORICAL 6 PERCENT GROWTH RATE PERSISTS, DEMAND WOULD QUADRUPLE BY THE YEAR 2000. IN ANY EVENT, EVEN OPTIMISTIC ESTIMATES OF THE LIKELY NUMBER OF DEEPSEA MINING OPERATIONS BY THE TURN OF THE CENTURY (ABOUT 15-20) POSTULATE THE NEED FOR A CONCURRENT INCREASE OF LAND-BASED SUPPLY. (FYI CONSERVATIVE BUMINES ESTIMATES SUGGEST A 3 PERCENT GROWTH RATE IN THE NICKEL MARKET TO 2000. THE CANADIAN ENERGY, MINES AND RESOURCES DEPARTMENT PROJECTS A 4.8 PERCENT RATE. TO PROVIDE FOR A MARGIN OF ERROR, INCLUDING POSSIBLE CONTINUATION OF THE HISTORICAL GROWTH RATE, WE HAVE USED THE 6 PERCENT FIGURE IN THE RSNT AND US POSITION. END FYI).

5. IT IS USEFUL TO RECALL THAT WHILE CANADA'S SHARE OF WORLD NICKEL PRODUCTION SHRANK FROM 80 PERCENT TO 30 PERCENT BETWEEN 1950-75, ITS DOMESTIC OUTPUT MORE THAN DOUBLED, FROM 112,000 ST TO 270,000 ST. WORLD PRODUCTION INCREASED FROM 145,000 ST TO 900,000 ST, AND ECONOMIC RESERVES EXPANDED EVEN FASTER, FROM 6.9 MILLION ST TO 61 MILLION ST. DURING THIS PERIOD, THE REAL PRICE OF REFINED NICKEL ROSE STEADILY, FROM \$1.38/POUND IN 1954 TO \$2.09/POUND IN 1976 (CONSTANT 1975 DOLLARS). THUS, RECENT

MAJOR ENTRANTS IN THE NICKEL MARKET, SUCH AS AUSTRALIA, NEW CALEDONIA, CUBA AND THE SOVIET UNION, HELPED TO MEET RISING DEMAND WITHOUT PRECLUDING EXPANSION OF CANADIAN CAPACITY OR CAUSING A PRICE COLLAPSE.

6. A RECENT (1976) STUDY PUBLISHED BY THE CANADIAN DEPARTMENT OF ENERGY, MINES AND RESOURCES PROJECTS WORLD NICKEL PRODUCTION GROWTH AT 4.8 PERCENT ANNUALLY FROM 1975 TO 2000. CANADIAN PRODUCTION, ACCORDING TO THIS FORECAST, WILL INCREASE AT A SLOWER RATE - 1.9 PERCENT (TO 429,000 ST). THESE ESTIMATES ASSUME FIVE SEABED MINING OPERATIONS COMING ON STREAM IN THE 1990'S, PRODUCING UP TO 200,000 ST OF NICKEL ANNUALLY. THAT 15-20 LIMITED OFFICIAL USE
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SEABED SITES WOULD LOWER THE CANADIAN GROWTH PROJECTION SEEMS DOUBTFUL. IF WORLD NICKEL DEMAND INCREASES AT A 3-6 PERCENT RATE, SEABED MINING SHOULD COMPLEMENT, RATHER THAN REPLACE, LAND-BASED PRODUCTION. MOREOVER, IF THERE IS DIVERSION OF INVESTMENT TO THE SEABED, IT IS MORE LIKELY TO BE AWAY FROM LATERITE DEPOSITS THAN FROM LOWER COST CANADIAN SULPHIDE DEPOSITS.

7. WITHOUT ANY SEABED MINING, THE PROJECTED GROWTH OF THE CANADIAN NICKEL INDUSTRY WOULD NOT NECESSARILY INCREASE, SINCE IT APPEARS THAT AT CURRENT PRICES AND TECHNOLOGY RESERVES COULD NOT SUPPORT A MUCH HIGHER RATE. THE PATTERN OF LAND-BASED INVESTMENT IN RECENT YEARS SUGGESTS A COLLECTIVE INDUSTRY JUDGEMENT THAT THE WORLD WILL HAVE TO RELY INCREASINGLY ON MORE PLENTIFUL LATERITE NICKEL DEPOSITS. ABOUT 70 PERCENT OF WORLD NICKEL RESERVES ARE IN LATERITE ORES, WHICH SHOULD ACCOUNT FOR MOST OF THE INCREMENTAL SUPPLY IN THE NEXT 25 YEARS. THE COUNTRIES POSSESSING THESE DEPOSITS (E.G., INDONESIA, PHILIPPINES, NEW CALEDONIA, DOMINICAN REPUBLIC, CUBA, GUATEMALA) ARE AGGRESSIVELY PROMOTING MINING INVESTMENTS.

8. THE LEADING CANADIAN NICKEL MINING FIRMS--INCO, FALCONBRIDGE AND SHERRIT GORDON--ALREADY HAVE SUBSTANTIAL FOREIGN INTERESTS OF THEIR OWN. ALTHOUGH CANADIAN SULPHIDE DEPOSITS HAVE LOWER PROCESSING COSTS THAN LATERITES, THESE FIRMS HAVE BEEN ATTRACTED BY THE SPECIAL INVESTMENT INCENTIVES OFFERED IN DEVELOPING COUNTRIES. FURTHERMORE, THEIR EFFORTS TO DIVERSIFY LAND-BASED NICKEL ORE SOURCES AND TO PARTICIPATE IN SEABED MINING PROBABLY REFLECT CONCERN ABOUT EVENTUAL DEPLETION OF CANADIAN NICKEL RESERVES. CURRENT CANADIAN DOMESTIC RESERVES (8.5-9.5 MILLION ST) WILL LAST ABOUT 25 YEARS, ASSUMING AN ANNUAL 2 PERCENT PRODUCTION INCREASE. IT SHOULD BE NOTED THAT THERE ARE LARGE UNPROVEN DEPOSITS WHICH ARE NOT COMMERCIALY VIABLE AT CURRENT PRICES BECAUSE

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OF LOW GRADE, SMALL SIZE, OR DIFFICULTY OF ACCESS. RECENT CANADIAN MINING COMPANY INVESTMENTS IN FOREIGN LATERITES SUGGEST THAT WORLD NICKEL PRICES WOULD HAVE TO RISE SUBSTANTIALLY BEFORE THESE SUBECONOMIC DEPOSITS BECAME COMMERCIALY EXPLOITABLE.

9. TO SUMMARIZE, CANADIAN GOVERNMENT CONCERN THAT SEABED MINING WILL THREATEN ITS DOMESTIC NICKEL INDUSTRY IS EXAGGERATED. IN THE FIRST PLACE, IT IS LIKELY THAT CANADIAN SULPHIDE ORES WILL RETAIN A PROCESSING COST ADVANTAGE OVER BOTH LATERITE ORES AND NICKEL FROM SEABED NODULES. SECOND, CONSERVATIVE FORECASTS OF THE NUMBER OF SEABED MINING OPERATIONS, STILL LEAVE A MARGIN FOR EXPANSION OF COMPETITIVE LAND-BASED CAPACITY. (THE GOC'S ENERGY, MINES AND RESOURCES DEPARTMENT FORECASTS THAT CANADA WILL CONTINUE TO LEAD THE WORLD IN NICKEL PRODUCTION AT THE END OF THE CENTURY, THOUGH ITS SHARE OF GLOBAL OUTPUT WILL DECLINE.) THIRD, THE MAJOR FACTORS INFLUENCING GROWTH OF CANADIAN NICKEL PRODUCTION TO THE END OF THE CENTURY ARE LIKELY TO RELATE TO THE RATE OF DOMESTIC RESERVE DEPLETION, POSSIBLE DEVELOPMENT OF NEW RESERVES, AND TECHNOLOGICAL ADVANCE IN MINING AND PROCESSING. TO THE EXTENT THAT THESE FACTORS ARE LIMITING, NEW INVESTMENT WOULD BE DIVERTED FROM CANADA TO OTHER COUNTRIES EVEN IN THE ABSENCE OF SEABED MINING. FINALLY, ALTHOUGH LONG TERM PROJECTIONS ARE HIGHLY SPECULATIVE, IT SEEMS SAFE TO SAY THAT ON THE BASIS OF CURRENT INVESTMENT TRENDS, CANADA'S DOMINANT ROLE IN THE NICKEL MARKET WILL DECLINE AFTER 2000. AT LEAST, THAT SEEMS TO BE A CONTINGENCY AGAINST WHICH CANADIAN MINING COMPANIES THEMSELVES ARE HEDGING.

10. NEITHER THE US POSITION IN THE LOS CONFERENCE NOR THE CURRENT DRAFT NEGOTIATING TEXT PURPORTS TO GUARANTEE ANY PORTION OF THE NICKEL MARKET FOR SEABED MINING. IN CONTRAST, THE CANADIAN LOS DELEGATION HAS SOUGHT TO LIMIT
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SEABED PRODUCTION TO NO MORE THAN HALF OF THE GROWTH SEGMENT IN THE WORLD NICKEL MARKET, A PROPOSAL WHICH WOULD GUARANTEE AT LEAST THE OTHER HALF TO LAND-BASED PRODUCERS.

11. WHILE THE USG SEEKS TO ESTABLISH A STABLE SEABED MINING REGIME IN WHICH FIRMS CAN MAKE RATIONAL INVESTMENT DECISIONS, WE HAVE NO INTENTION TO SUBSIDIZE THE DEVELOPMENT OF A SEABED MINING INDUSTRY. GIVEN CURRENT

AMPLE AND DIVERSIFIED LAND SOURCES OF MOST NODULE MINERALS, WE DO NOT FIND A COMPELLING STRATEGIC URGENCY TO DEVELOP THE SEABED AT ANY COST. WE DO, HOWEVER, PERCEIVE AN IMPORTANT ECONOMIC INTEREST IN ASSURING NON-DISCRIMINATORY ACCESS TO THE SEABED FOR US AND FOREIGN MINERS, IN ORDER TO ENCOURAGE DEVELOPMENT OF SEABED RESOURCES, DIVERSIFY MARKETS, AND CREATE BENEFITS FOR MINERAL CONSUMERS.

12. IF SEABED MINING PROVES VIABLE, WE WOULD NATURALLY EXPECT IT TO GAIN A SHARE OF THE WORLD MARKET. THE INTENT OF THE DRAFT TEXT (ARTICLE 9) IS THAT THE RELATIVE COMPETITIVENESS OF SEABED MINING WILL DETERMINE THE SIZE OF THAT SHARE. THEREFORE, IT IS INCORRECT TO CHARACTERIZE THE PRODUCTION LIMITS IN THE NEGOTIATING TEXT AS A "FLOOR" (REFTEL), SINCE ACTUAL SEABED PRODUCTION COULD BE ZERO IF COSTS ARE NON-COMPETITIVE. THE TEXT WOULD PERMIT, BUT IN NO WAY ASSURE, SEABED PRODUCTION TO FILL THE GROWTH SEGMENT OF THE WORLD NICKEL MARKET, COMPUTED ON THE BASIS OF THE HISTORICAL TREND. THESE GUIDELINES ARE INTENDED TO PROVIDE ADEQUATE POTENTIAL SCOPE FOR DEVELOPMENT OF A COMPETITIVE SEABED MINING INDUSTRY, WHILE ASSURING LAND-BASED PRODUCERS THAT THEIR CURRENT INVESTMENTS WOULD NOT BE JEOPARDIZED. PROTECTION FOR DEVELOPING COUNTRY PRODUCERS ALSO INCLUDES A SPECIAL COMPENSATORY FINANCE FACILITY IN CASE OF ADVERSE EFFECTS ON EXPORT REVENUES AS A RESULT OF SEABED MINING.

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13. WHILE THESE COMPROMISE PROVISIONS DO NOT REPRESENT OUT PREFERRED POSITION, THE US HAS ACCEPTED THEM SINCE THEY DO NOT SEVERELY DILUTE THE PRINCIPAL OBJECTIVE OF ENCOURAGING DEVELOPMENT OF ECONOMIC SOURCES OF THE MINERALS INVOLVED. THE THRUST OF CANADIAN CRITICISM OF ARTICLE 9 GOES BEYOND QUESTIONS ABOUT THE VALIDITY OF A PARTICULAR GROWTH PROJECTION. CANADA WOULD CLEARLY PREFER PROVISIONS THAT PUT THE MAJOR EMPHASIS ON PROTECTION OF LAND-BASED PRODUCERS. AS NOTED EARLIER, WE DOUBT THAT TIGHT RESTRICTIONS ON SEABED MINING WILL EFFECTIVELY PROTECT CANADA'S NICKEL INDUSTRY. CANADA'S NICKEL RESERVE BASE MAY LIMIT LARGE CAPACITY EXPANSION, AND IN ANY EVENT IT FACES STIFF COMPETITION FOR INVESTMENT FUNDS FROM COUNTRIES WITH PLENTIFUL LATERITE DEPOSITS.

14. FURTHERMORE, WE DOUBT THAT CANADA'S NARROWLY PROTECTIONIST STANCE SERVES THE LONG TERM INTERESTS OF A HIGHLY INDUSTRIALIZED NATION. EXPLOITATION OF THE DEEP SEABED IS STILL IN ITS PIONEERING STAGE, CHARACTERIZED BY LIMITED DATA ABOUT THE RESOURCES AVAILABLE AND INABILITY TO FORESEE THE FULL EXTENT OF TECHNOLOGICAL SPINOFFS.

CANADA IS AMONG THE SMALL NUMBER OF COUNTRIES WITH THE
TECHNICAL EXPERTISE, MANAGERIAL AND CAPITAL CAPACITY TO
TAKE AN ACTIVE ROLE IN THE EARLY DEVELOPMENT OF THE SEABED
AND ULTIMATELY TO SHARE IN THE PROFITS. THOSE ENDOWMENTS
AND INTERESTS WOULD SEEM TO TRANSCEND CANADA'S INTEREST IN
ITS NICKEL INDUSTRY, WHICH CONTRIBUTES LESS THAN ONE
PERCENT OF CANADA'S GNP AND EMPLOYS 0.3 PERCENT OF ITS
LABOR FORCE.

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